AR35

PINNACLE PETROLEUMS LTD.

ANNUAL REPORT 1970

INCORPORATED UNDER THE LAWS OF THE PROVINCE OF ALBERTA

HEAD OFFICE:
THIRD FLOOR
703 FIFTH STREET S.W.,
CALGARY 2, ALBERTA

DIRECTORS:
D. B. BULLOCK, CALGARY, ALBERTA
R. L. BORDEN, CALGARY, ALBERTA
W. C. BUMPERS, CHICAGO, ILLINOIS
D. S. JONES, CALGARY, ALBERTA
J. A. MCAULEY, DALLAS, TEXAS
W. H. MOLLE, TORONTO, ONTARIO
H. S. RHODES, CALGARY, ALBERTA

OFFICERS:
D. B. BULLOCK, PRESIDENT
H. S. RHODES, VICE-PRESIDENT
D. S. JONES, SECRETARY

AUDITORS:
PEAT, MARWICK, MITCHELL & CO.,
CALGARY, ALBERTA

SOLICITORS:
BURSTALL, CLARKE, JONES & COADY
CALGARY, ALBERTA

FENERTY, MCGILLIVRAY, ROBERTSON,
PROWSE, BRENNAN, FRASER, BELL & CODE
CALGARY, ALBERTA

BANKERS:
THE BANK OF MONTREAL, MAIN BRANCH,
CALGARY, ALBERTA

REGISTRAR:
MONTREAL TRUST COMPANY,
AT ITS OFFICES:
CALGARY, ALBERTA
VANCOUVER, B.C.
TORONTO, ONTARIO
MONTREAL, QUEBEC

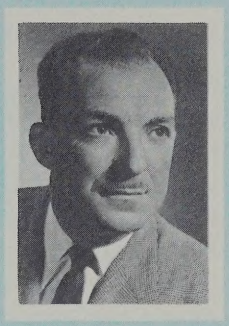
LISTING:
TORONTO STOCK EXCHANGE

ANNUAL MEETING:

The Annual Meeting will be held at 10:00 a.m., Wednesday, December 23, 1970, at the head office of the Company, Third Floor, 703 Fifth Street s.w., Calgary, Alberta

NOTE:

The Financial Statement in this Report covers the period April 1, 1969 to March 31, 1970. The Report to the shareholders covers activities up to November 23, 1970.



President's Report To Shareholders

A number of severe challenges which faced your Company during the past year have been met successfully. Principal among these challenges has been financial stability in a time of economic stress throughout Canada.

Your Company has achieved that stability and is now poised to take advantage of a potential that has seldom, if ever, been available to our industry.

Expanding markets for Canadian petroleum products portend a great future, both short and long term, for western Canadian oil companies. Your Company is in an excellent position to benefit from this market expansion.

In addition to these markets your Company has prepared itself to take advantage of a still greater market - the United Kingdom. Through its wholly owned subsidiary Grizzly Exploration (U.K.) Limited, your Company holds interests in acreage in the North Sea and petroleum licenses on over two million acres of land which has excellent prospects for major reserves of petroleum and natural gas. The land acreage lies in the heart of the English market which uses over 2,000,000 barrels of oil daily at a price of about $3.00 per barrel.

Your Company has also entered the minerals side of the resources field with an active exploration program adjacent to an area where very high grade values of copper ore are being produced. Mineral exploration continues to play an important role in the economic picture in Canada, and your Company's activities are planned to take advantage of a portion of that market.

Some of the detail of the activities of the past year and more important, the things your Company will be doing to realize on its great potential, are presented on the following pages.

D. Bruce Bullock,
President

ENGLAND

Tanker rates, instability in the Middle East and a rapidly expanding demand for oil have combined to make the British market of prime importance. Over 2,000,000 barrels of crude oil are imported into the United Kingdom daily. Average price of the crude in England is $3.00 per barrel.

Exploration activity in the British Isles has accelerated in the past year. North Sea discoveries have focused attention away from the mainland areas where several companies are presently either conducting geophysical surveys or preparing to drill. Your Company has a planned exploration program for its large on-shore holdings. This program includes the drilling of nine wells the first of which will be spudded as soon as permission is granted by the regulatory bodies. All the criteria for the generation and accumulation of large reserves of oil and gas are present within the company's holdings.

Pinnacle, through its English subsidiary Grizzly Exploration (U.K.) Ltd., holds 12½% carried working interest in Licence P 053 Block 48/23 in the North Sea. A well will be drilled on this block next summer, to evaluate a strongly defined seismic structural feature on the north half of the block. This well will evaluate all formations down to, and including the basal Permian sands.

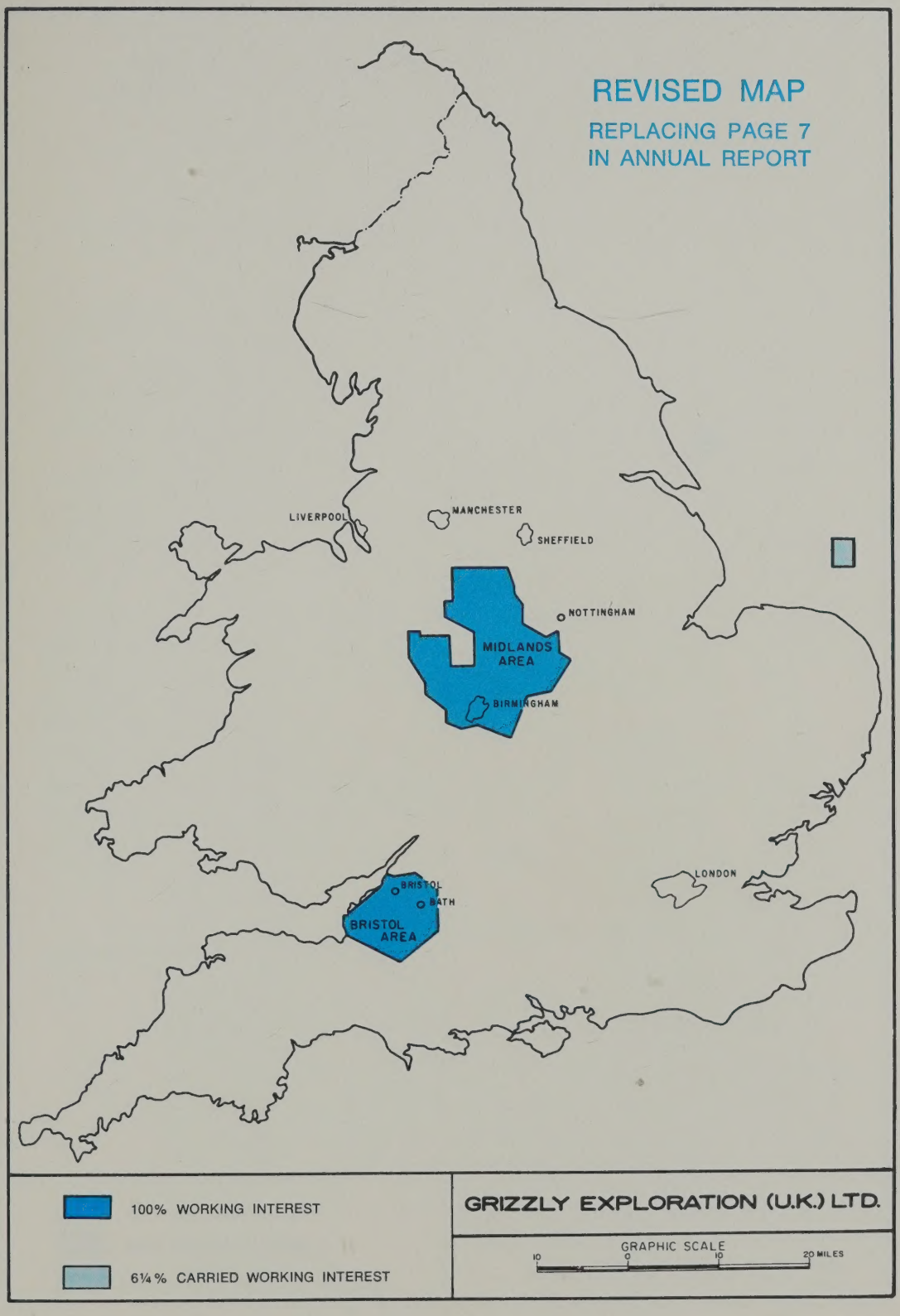
The Hewitt gas field produces gas from the basal Permian sand, and is located on strike five miles south of Block 48/23. Oil was found in uncommercial quantities on the west adjoining block.

Grizzly will hold 6¼% carried working interest in this block after the well is drilled.

MINING

Your Company has entered into an agreement with Northeast Exploration Ltd. of Chibougamau, Quebec, to explore twenty-eight claims to earn up to 75% interest. These claims adjoin the property of Icon Sullivan Joint Venture which is producing copper concentrates having a value of over $6.000,000 annually. Trenching and drilling on these claims has revealed bed rock type and structure to be similar to that found at the Icon producing property. Exploration will continue as long as weather permits.

Your Company has a small interest in a Molybdenum showing in South Central British Columbia. Good values have been found in preliminary trenching on the property. Negotiations are presently underway with a large mining group to take over the exploration and development of these claims.


REVISED MAP
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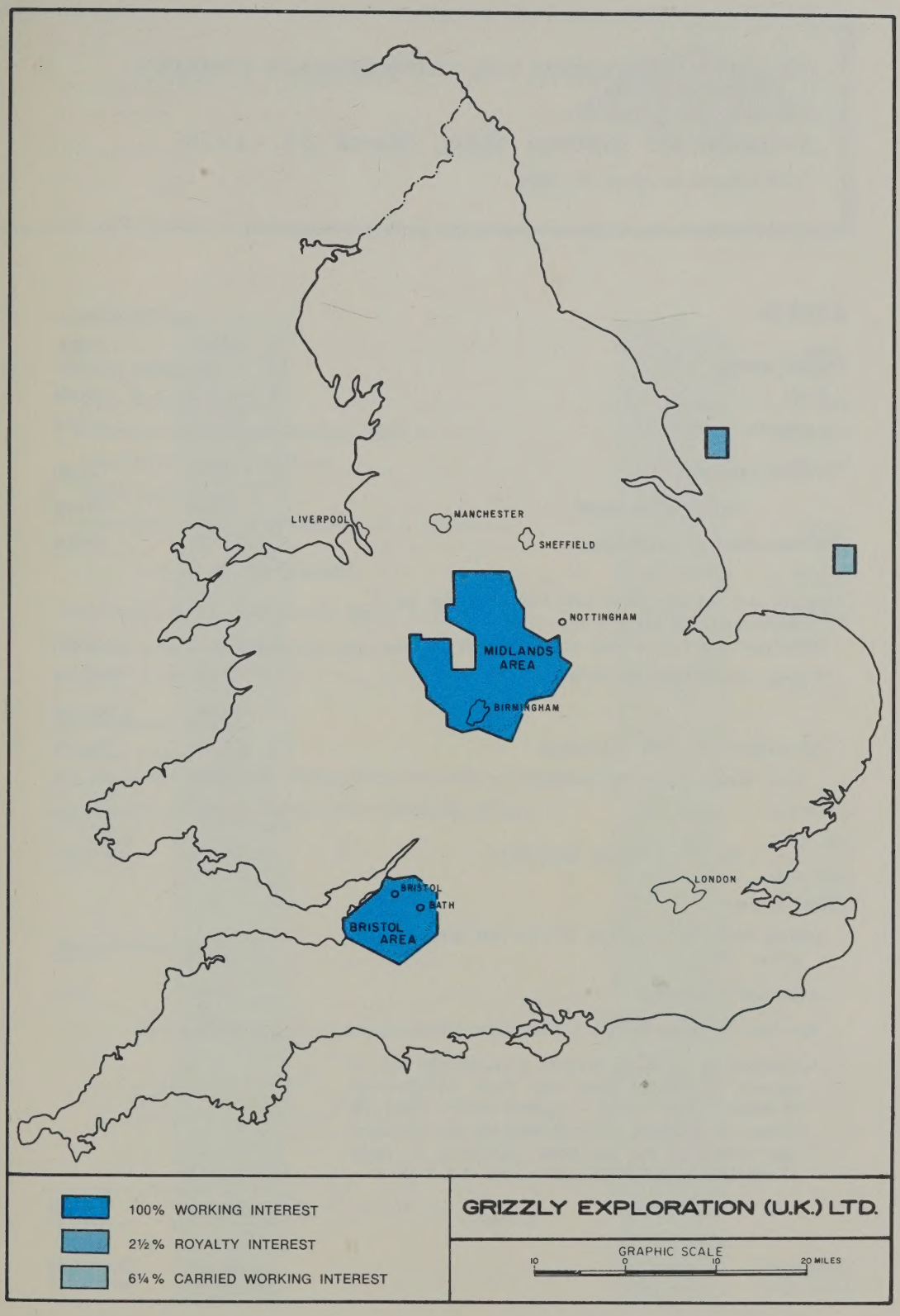
IN ANNUAL REPORT
LIVERPOOL
MANCHESTER
SHEFFIELD
NOTTINGHAM
MIDLANDS AREA
BIRMINGHAM
LONDON
BRISTOL
BATH
BRISTOL AREA
100% WORKING INTEREST
6¼% CARRIED WORKING INTEREST
GRIZZLY EXPLORATION (U.K.) LTD.
GRAPHIC SCALE
10 0 10 20 MILES


LIVERPOOL
MANCHESTER
SHEFFIELD
NOTTINGHAM
MIDLANDS AREA
BIRMINGHAM
BRISTOL
BATH
BRISTOL AREA
LONDON
100% WORKING INTEREST
2½% ROYALTY INTEREST
6¼% CARRIED WORKING INTEREST
GRIZZLY EXPLORATION (U.K.) LTD.
GRAPHIC SCALE
10 0 10 20 MILES

PINNACLE PETROLEUMS LTD. AND SUBSIDIARY COMPANY

Consolidated Balance Sheet March 31, 1970

(with comparative figures for 1969)

ASSETS

	1970	1969
Current assets:		
Cash	$ 14,519	$ 26,974
Accounts receivable	60,310	96,819
Prepaid expenses	4,573	2,606
Total current assets	79,402	126,399
Deferred accounts receivable	27,683	28,058
Property and equipment, at cost less depletion and depreciation (Notes 6 & 8):		
Petroleum and natural gas properties (Note 1)	4,330,595	3,246,338
Less accumulated depletion	493,907	283,253
	3,836,688	2,963,085
Production and other equipment	911,726	714,499
Less accumulated depreciation	406,339	252,440
	505,387	462,059
Net property and equipment	4,342,075	3,425,144
Other assets:		
Drilling and other deposits, at cost less amounts written off	42,756	29,825
Incorporation costs	5,401	4,517
Due from D. Bruce Bullock & Associates Ltd.	32,629	—
Agreement by D. Bruce Bullock & Associates Ltd. to assume liability of bank loan from the Bank of Montreal - see contra - against which 1,541,700 shares of Pinnacle Petroleums Ltd. are pledged, less allowance for estimated deficiency in value of shares pledged $1,600,000 (Notes 2 & 8 (b))	1,203,112	—
	1,283,898	34,342
	$5,733,058	$3,613,943

(Subject to the accompanying report of Peat, Marwick, Mitchell & Co., Charte

See

LIABILITIES

	1970	1969
Current liabilities:		
Bank loans (Note 3)	$ 146,700	$ 401,500
Accounts payable and accrued liabilities	673,553	191,301
Debentures payable (Note 4)	688,147	397,458
9¾% loan payable	140,000	—
Promissory note and conditional sales agreement	—	19,948
Total current liabilities	1,648,400	1,010,207
Bank loans, less current portion (Notes 3 and 8)	513,275	385,892
Demand bank loan ($2,600,000 U.S. funds) (Notes 2, 3 and 8 (b))	2,803,112	—
Shareholders' equity:		
Share capital (Note 5): Authorized 7,000,000 shares without nominal or par value		
Issued 5,380,895 shares (1969 - 3,818,500 shares)	5,774,799	3,118,728
Deficit	5,006,528	900,884
	768,271	2,217,844
	$5,733,058	$3,613,943

Commitments (Note 6)

Approved on behalf of the Board

....., Director

....., Director

ccountants dated June 15, 1970 and November 6, 1970 as to Notes 2 and 8).
panying notes.

PINNACLE PETROLEUMS LTD.
AND SUBSIDIARY COMPANY

Consolidated Statement of Earnings and Deficit Year ended March 31, 1970

(with comparative figures for 1969)

	1970	1969
Revenue:		
Crude oil sales	$ 263,569	$ 228,592
Interest and other income	10,491	15,069
	274,060	243,661
Expenses - net:		
Operating	174,922	153,304
Salaries and employee benefits	79,073	126,912
General and administrative	202,840	136,439
Interest - long term	53,315	46,770
- other	117,914	30,784
Depreciation	125,124	95,481
Depletion	104,036	68,018
Write down in carrying value of petroleum and natural gas properties (Note 8 (c))	1,960,000	—
Sundry	4,981	6,281
Expenses recovered	(22,662)	(114,089)
	2,799,543	549,900
Less engineering fees and other charges to participants	19,839	25,775
	2,779,704	524,125
Net loss before extraordinary item	2,505,644	280,464
Extraordinary item:		
Provision for estimated deficiency under an agreement (Notes 2 and 8)	1,600,000	—
Net loss	4,105,644	280,464
Deficit beginning of year	900,884	620,420
Deficit end of year	$5,006,528	$ 900,884

See accompanying notes.

(Subject to the accompanying report of Peat, Marwick, Mitchell & Co., Chartered Accountants dated June 15, 1970 and November 6, 1970 as to Notes 2 and 8).

PINNACLE PETROLEUMS LTD.
AND SUBSIDIARY COMPANY

Consolidated Statement of Source and Application of Funds Year ended March 31, 1970

(with comparative figures for 1969)

	1970	1969
Source of funds:		
Proceeds from sales of shares of capital stock	$2,656,071	$ 381,400
Proceeds from disposal of capital assets	352,491	678
Increase in bank loans - net	127,383	—
Sundry	6,524	29,086
Total source of funds	3,142,469	411,164
Use of funds:		
Net loss for the year	4,105,644	280,464
Deduct non-cash items:		
Extraordinary item (Note 2)	1,600,000	—
Depletion	104,036	68,018
Depreciation	125,124	95,481
Write down in carrying value of petroleum and natural gas properties (Note 8 (c))	1,960,000	—
Other	3,092	5,136
	3,792,252	168,635
Use of funds on operations	313,392	111,829
Increase in amount due from D. Bruce Bullock & Associates Ltd.	32,629	—
Petroleum and natural gas properties	564,301	565,378
Production and other equipment	175,934	163,276
Acquisition of subsidiary companies for shares issued including agreement to assume bank loan (Note 2)	5,369,934	—
Less bank loan to be assumed (Note 2)	2,803,112	—
	2,566,822	—
Working capital deficiencies of subsidiary companies at date of acquisition	174.581	—
Reduction in non-current debt	—	34,049
Deferred accounts receivable	—	28,058
Total use of funds	3,827,659	902,590
Increase in working capital deficiency	$ 685,190	$ 491,426

See accompanying notes.

(Subject to the accompanying report of Peat, Marwick, Mitchell & Co., Chartered Accountants dated June 15, 1970 and November 6, 1970 as to Notes 2 and 8).

PINNACLE PETROLEUMS LTD.
AND SUBSIDIARY COMPANY

Notes to the Consolidated Financial Statements
March 31, 1970

1. Principles of Consolidation

The consolidated financial statements include the accounts of Pinnacle Petroleums Ltd. and those of its wholly-owned subsidiary companies, Baldonnel Oil & Gas Ltd., Midalta Oil Company Limited (acquired August 18, 1969 (See notes 2 and 8 (c)) and Grizzly Petroleum Limited (acquired August 21, 1969). The operations of the subsidiaries acquired during the year are included in the consolidated statement of earnings from their respective dates of acquisition.

The excess of the purchase price of the shares of the subsidiaries over their underlying net book values at dates of acquisition amounting to $2,567,698 has, on consolidation, been added to petroleum and natural gas properties and is being depleted on consolidation (See also note 8 (c)).

The companies follow the "full cost" method of accounting wherein all costs and expenses of exploring for and developing oil and natural gas reserves are capitalized and depleted over the productive lives of the properties on a composite unit of production basis (See also note 8 (c)).

2. (a) On June 9, 1969, prior to becoming a wholly-owned subsidiary company, Midalta Oil Company Limited acquired from a certain shareholder 1,913,000 shares of Pinnacle Petroleums Ltd. Payment for these shares was made from the proceeds of a demand bank loan from the Bank of Montreal totalling $2,600,000 (U.S. funds). As part of the security for such bank loan 1,541,700 of these shares were pledged to the Bank of Montreal.

Greyhound Leasing & Financial Corporation entered into an agreement with the Bank of Montreal wherein Greyhound has agreed to pay to the Bank on or before June 9, 1971 an amount equal to the then outstanding principal balance of the amount due to the Bank of Montreal by Midalta Oil Company Limited, including accrued interest thereon (See also note 8 (c)). In addition, upon the fulfillment by Greyhound of its obligation to make such payment and as a condition of such payment, the Bank shall assign and transfer the loan to Greyhound, together with all of the Bank's rights, title, interest and security in such loan, including 1,541,700 shares of Pinnacle Petroleums Ltd. referred to above.

In consideration of Greyhound Leasing & Financial Corporation entering into the agreement referred to above, 171,300 shares of the 1,913,000 shares were transferred to Greyhound Leasing & Financial of Canada Ltd.

(b) Under an agreement dated August 18, 1969, Midalta Oil Company Limited sold to D. Bruce Bullock & Associates Ltd. (all of the issued and outstanding shares of which were owned by Messrs. D. B. Bullock, H. S. Rhodes and A. Muirhead) all of the remaining 1,742,700 shares of Pinnacle Petroleums Ltd. owned by Midalta Oil Company Limited subject to all liens, encumbrances and pledges, including the pledge of 1.541,700 shares thereof to the Bank of Montreal, referred to above. In consideration of such sale D. Bruce Bullock & Associates Ltd. agreed to assume the obligations, both present and contingent, including the demand loan from the Bank of Montreal, arising out of the purchase of such shares on June 9, 1969, referred to above.

This transaction has been recorded in the accompanying balance sheet under the heading "Other assets" in the amount of $2,803,112 being approximately the Canadian dollar equivalent of $2,600,000 at August 8, 1969. An allowance of $1,600,000 has been provided in the accompanying financial statements being the

2. (b) Continued

estimated deficiency in the market value of the 1,541,700 shares of the company pledged to the Bank of Montreal. This estimated deficiency has been calculated based upon the price per share at the close of trading on the Toronto Stock Exchange on November 6, 1970 and on the assumption that the shares so pledged to the Bank of Montreal together with the 1,259,895 shares owned by Mr. D. B. Bullock as described in notes 5 and 8 (c) (which together under agreements between the Bank of Montreal, D. B. Bullock, Greyhound Leasing & Financial Corporation and certain other parties comprise effective control of the company) could be sold en bloc and would, in the opinion of management, realize not less than the closing market price per share at November 6, 1970 being approximately 80 cents per share.

3. Pinnacle Petroleums Ltd. and a subsidiary company have pledged certain producing oil properties and revenue therefrom in accordance with Section 82 of the Bank Act as security for the bank loans. These loans are also secured by a general assignment of book debts of the company and the subsidiary (See note 8).

Although the loans are payable on demand, under the agreed terms of repayment, approximately $146,700 will be required to be repaid in the next twelve months and this amount has been included in current liabilities. The demand bank loan is also payable on demand, however under the agreed terms of repayment this loan is due on June 9, 1971 (See note 2). The interest payable on this demand loan is at the rate obtained by adding to the minimum New York prime rate for United States dollars an additional rate of two and one-half percent per annum.

4. Debentures payable consist of the following:

17½% Single Debenture, due September 1, 1970	$510,000
14% Series Debentures, payable on demand after June 21, 1970	178,147
	$688,147

The debentures are secured by a first floating charge on all of the property and assets of the company save and except petroleum and natural gas leases and equipment thereon specifically pledged in connection with the company's banking indebtedness (See note 8).

5. Share Capital:

Shares in the capital stock of the company have been issued during the year as follows:

Number of Shares		Ascribed Value
1,259,895 shares	for all of the issued and outstanding shares of Midalta Oil Company Limited at a value of $1.70 per share	$2,141,821
250,000 shares	for all of the issued and outstanding shares and all of the outstanding debentures and notes payable of Grizzly Petroleum Limited	425,000
52,500 shares	for certain petroleum and natural gas properties	89,250
1,562,395 shares		$2,656,071

5. Share Capital - continued

The following stock options were outstanding as of March 31, 1970:

Number of shares	Option price	Exercisable	Termination date
8,000	$1.35	1/5 per annum, cumulative	December 31, 1976 or termination of employment
100,000	1.40	any time	August 17, 1972
12,500	1.40	1/5 per annum, cumulative, commencing Oct. 1, 1970	September 15, 1979 or termination of employment
2,500	3.23	1/5 per annum, cumulative	December 31, 1976 or termination of employment
123,000			

During the year options were granted to an employee and to others covering 112,500 shares in the capital stock of the company at a price of $1.40 per share under the conditions set out above. Options for 77,000 shares were cancelled during the year as a result of termination of employment.

6. Under the terms of an agreement between Pinnacle Petroleums Ltd. and D. Bruce Bullock & Associates Ltd., management services are provided to Pinnacle Petroleums Ltd. for a three-year term from August 18, 1969 at the rate of $5,000 per month.

Under the terms of a lease of office premises, Pinnacle Petroleums Ltd. is obligated to pay rentals aggregating $20,220 per annum for a three-year term from August 1, 1969.

7. The aggregate direct remuneration paid to directors and senior officers by Pinnacle Petroleums Ltd. was $58,124.

8. Subsequent events:

(a) On June 12, 1970, certain petroleum and natural gas properties and production equipment of the company were sold for a net cash consideration of $3,785,000. The properties sold represent approximately 93% of the total proven oil and natural gas reserves of the companies at March 31, 1970.

The net proceeds have partly, to November 6, 1970, been used as follows:

Retirement of bank loans	$659,975
Retirement of 9¾% loan payable and accrued interest	154,403
Retirement of debentures payable	688,147
Exploratory costs Arctic Permits (note 8 (c))	229,116
Advances to other companies	250,000
Payment of accounts payable and accrued liabilities	675,000
Advance on behalf of D. Bruce Bullock & Associates Ltd. (See 8 (b) below)	302,000
Purchase of 7½% deposit receipts of Fort Garry Trust Company, due December, 1970	400,000

8. Subsequent events - continued

(b) Subsequent to March 31, 1970 a subsidiary company sold an interest in the Arctic Permits to its parent company for $302,000. On September 28, 1970 the subsidiary company advanced $302,000 on behalf of D. Bruce Bullock & Associates Ltd. in connection with certain obligations under the agreement dated August 18, 1969 (see note 2). No provision for loss has been provided in connection with this transaction.

(c) As set out in notes 1 and 5 the company acquired on August 18, 1969, all the issued and outstanding shares of Midalta Oil Company Limited from Mr. D.B. Bullock by the issue of 1,259,895 shares of the company (see note 2). At that date, Midalta held a substantial interest in certain Arctic Permits in Northern Canada, subject to the performance of work obligations to be carried out at various future dates and to the indemnification of the licensed operator of the permits against any liability arising in connection therewith.

On June 11, 1970, Toltec Mines Limited, the licensed operator of the permits, entered into an agreement with D. Bruce Bullock & Associates Ltd. to carry out, at a turnkey price of $225,000, certain work obligations required under the terms of the permits. Under the indemnification agreement with Toltec Mines Limited this amount was charged to Midalta Oil Company Limited.

In addition, further work obligations on these permits were required to be performed and as security the company was required to issue deposits in the amount of $720,000 on or before November 6, 1970. On November 5, 1970 the company and Toltec Mines Limited assigned their interest in these permits, retaining a 3% overriding royalty. Prior to this sale the carrying value of these and other properties of Midalta Oil Company Limited was approximately $2,670,000.

As set out above the company sold approximately 93% of its proven reserves which resulted in a gain on disposal of approximately $710,000. As a result of the aforementioned transactions the carrying value of the company's and subsidiaries' petroleum and natural gas properties has been written down, as at March 31, 1970, by $1,960,000.

9. For income tax purposes the companies are entitled to claim drilling, exploration and lease acquisition costs and capital cost allowances (depreciation for tax purposes) in amounts which may exceed the related depletion and depreciation provisions reflected in their accounts. For 1970 the companies do not intend to claim excess capital allowances but will claim the other specified deductions in amounts sufficient to eliminate taxable incomes, and expenditures remain to be carried forward and applied against future taxable income as follows:

Drilling, exploration and lease acquisition costs	$4,840,740
Undepreciated capital cost	610,890

Management does not believe that it is appropriate to provide for income taxes deferred as a result of claims for drilling, exploration and lease acquisition costs; while the view of management conforms with gereral practice in the oil and gas industry and is accepted by accounting authorities outside Canada, it differs from the tax allocation basis of accounting recommended by the Accounting and Auditing Research Committee of The Canadian Institute of Chartered Accountants under which the income tax provision is based on the income reported in the accounts.

On a cumulative basis to March 31, 1970 the companies have written off in their accounts approximately $386,000 in excess of the capital cost allowances and drilling, exploration and lease acquisition costs claimed for income tax purposes.

PEAT, MARWICK, MITCHELL & CO.
CHARTERED ACCOUNTANTS

309 EIGHTH AVENUE WEST
CALGARY, ALBERTA

Auditors' Report to the Shareholders

We have examined the consolidated balance sheet of Pinnacle Petroleums Ltd. and subsidiary companies as of March 31, 1970 and the consolidated statements of earnings and deficit and source and application of funds for the year then ended. Our examination included a general review of the accounting procedures and such tests of accounting records and other supporting evidence as we considered necessary in the circumstances except in regards to the valuation of the amount carried in the accompanying balance sheet under the heading "Other Assets" in the amount of $1,203,112.

Under an agreement dated August 18, 1969 D. Bruce Bullock & Associates Ltd. agreed to assume a bank loan. At March 31, 1970 and at the date of our report a subsidiary company still remains directly liable for this loan to the bank. As referred to in note 2 (a) the Bank of Montreal holds certain shares as security for this indebtedness representing approximately 28% of the outstanding shares of Pinnacle Petroleums Ltd. Because of the present market value of these shares the Company has provided, as described in note 2 (b), an allowance of $1,600,000 in connection with this transaction.

Due to the number of shares involved and the subsequent payment of $302,000 as described in note 8 (c) the amount of $1,203,112 may not be indicative of final realization.

In our opinion, subject to the valuation referred to in the preceding paragraph, these consolidated financial statements present fairly the financial position of the Company and its subsidiary companies at March 31, 1970 and the results of their operations and the source and application of their funds for the year then ended, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Calgary, Alberta
June 15, 1970
November 6, 1970 as to notes 2 and 8

Peat, Marwick, Mitchell & Co.
Chartered Accountants

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CALGARY, ALBERTA, CANADA